United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2175

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United States Court of Appeals

FOR THE SECOND CIRCUIT

In the Matter of Zalmen A. Dunn,

Bankrupt,

ZALMEN A. DUNN,

Bankrupt-Appellant,

—against—

SAMUEL A. ARUTT,

Trustee-Appellee.

On Appeal from the United States District Court
Eastern District of New York

APPELLANT'S BRIEF

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Preliminary Statement

The bankrupt, Zalmen A. Dunn, petitions this Court for review of an order of Chief Judge Jacob Mishler affirming an order of Bankruptcy Judge William J. Rudin, dated March 13, 1974, sustaining Specification 3(c) of the trustee's objections to the bankrupt's discharge and denying the bankrupt a discharge in bankruptcy (Appendix p. 38a).

Questions Presented

1. Did Chief Judge Jacob Mishler err in deciding that Bankruptcy Judge William J. Rudin had made sufficient findings of fact from which he could conclude that the bankrupt's records were insufficient to establish the actual indebtedness from Mid-Island Dental Supply Corp.?

2. Is the failure of the bankrupt to establish prima facie from his records an obligation owed to him from a third party (Mid-Island) sufficient justification to deny him a discharge?

Statement of Facts

Of five Specifications originally pleaded (containing 19 subsections) in the objections to the bankrupt's discharge dated December 2, 1967, seven years later we are left with one subsection of a Specification, fourteen of the Specifications having been dismissed and four withdrawn by the trustee (Appendix p. 15a).

The Specifications Remaining

Specification 3(c) reads as follows:

> "Third Specification:
>
> "Said bankrupt has, with intent to conceal his financial condition, failed to keep books of account or records, from which such condition might be ascertained:
>
> "c. That Mid-Island Dental Supply Corp. is indebted to him in the sum of $123,230.72, i.e. Schedule B-3 whereas in truth and in fact the bankrupt has stated in writing on October 31, 1966 that Mid-

Island Dental Supply Corp. was indebted to him for $83,049.79 and in a written audit of his records prepared by an accountant on his behalf and delivered to the trustee his auditor therein specified that the indebtedness from Mid-Island Dental Supply Corp. was $51,333.87."

Proceedings Below

By order dated July 25, 1974 Chief Judge Mishler affirmed a decision of Bankruptcy Judge Rudin sustaining specification 3(c) of the trustee's objections to the Bankrupt's discharge and denying the Bankrupt his discharge.

Subsection 3(c) represents the sole barrier to the Bankrupt's discharge.

By decision dated December 18, 1972 Bankruptcy Judge Rudin sustained specification 3(c). By decision dated May 23, 1974 chief Judge Mishler reversed and remanded the matter to Judge Rudin. Upon remand Judge Rudin again sustained specification 3(c) and was affirmed on appeal by Judge Mishler.

It is respectfully submitted that the Bankruptcy Judge and the District Court made insufficient and irrelevant findings of fact, misread applicable law and that under the circumstances herein the specification should be dismissed and the bankrupt granted his discharge.

POINT I

Chief Judge Mishler erred in deciding that Bankruptcy Judge Rudin had made sufficient findings of fact from which he could conclude that the bankrupt's records were insufficient to establish the actual indebtedness from Mid-Island Dental Supply Corp.

Judge Mishler's Remand

In the memorandum of decision and order when the bankrupt petitioned the court for a review of an order of Bankruptcy Judge William J. Rudin dated December 18, 1972, sustaining Specifications 3(c), 3(d) and 4(a) and denying the bankrupt's discharge, Judge Mishler reversed the Bankruptcy Judge's order of December 18, 1972 as to Specification 3(d) and 4(a) and dismissed the Specifications and remanded the matter for further hearings and/or findings relating to Specification 3(c) consistent with his decision.

Judge Mishler ruled:

> "Specification 3(c) cannot be dealt with so easily; it involves relatively large discrepancies which certainly would be material. However, the standard for the denial of a discharge under section 14c (2) is not whether the figures the bankrupt lists in his schedules are inconsistent with those figures he claimed as assets or liabilities at other times. Rather, the trustee must show either that bankrupt's records are indecipherable or unintelligible, or that the records present a misleading picture of the true status of the bankrupt's financial affairs. To sustain specification 3(c), there must be a finding that the actual amount of the bankrupt's claim against Mid-Island cannot be substantially ascertained by reference to his records. The referee has made no such finding."

The Bankruptcy Judge's Memorandum dated February 19, 1974

Conspicuously absent from the Bankruptcy Judge's decision is *any* finding of fact that the bankrupt's records or books were insufficient to indicate an obligation of $123,230.72 from Mid-Island Dental Supply Corp. (Mid-Island). This, in spite of the remand by Judge Mishler dated May 24, 1973, which states "to sustain Specification 3(c), *there must be a finding that the actual amount of the bankrupt's claim against Mid-Island cannot be substantially ascertained by reference to his records. The Referee has made no such finding.*" (emphasis added) What we do have are findings immaterial to the specification and having no relevancy whatsoever to the issue involved. Consequently Judge Rudin attempted to rehash all previous specifications and confused the issue before him. At page 8 of his decision (Appendix p. 34a), he stated the erroneous issue to be "However, we are dealing with the issue of maintaining records from which his financial condition could be ascertained and his records fall short of the criterion." We urge that Judge Rudin misstated the issue, for we are not concerned nor are we dealing with the general issue of maintaining records from which a financial condition could be ascertained. We are concerned, as Judge Mishler indicated in his remand, with the indebtedness of Mid-Island to the bankrupt and the records of Dr. Dunn in support of that obligation, and nothing else.

Because of the misstatement as to the issue, Judge Rudin made erroneous Findings of Fact and Conclusions of Law and discussed evidence neither material nor relevant (App. 28a-29a).

Thus Findings of Fact 1 and 2 have no relevance to the Specifications and relate only to specifications already dismissed.

Finding 4 is in error as to the letter's addressee. Judge Rudin either knowingly or unknowingly would have us believe that the bankrupt wrote a letter *to the trustee* in 1966. The fact is that the bankrupt's petition was not filed until *1967* and a letter was sent to an attorney who subsequently became the attorney for the trustee in the bankruptcy proceeding (a letter, not under oath, which was sent without the advice of an accountant or counsel).

Finding Paragraph 5 was structured upon a report made in *1966* before the bankruptcy proceedings (SM p. 61, December 28, 1971 Appendix p. 63a) and not upon an *audit* as indicated by Judge Rudin. Furthermore, such finding is misleading and indicates that the party preparing the report was the bankrupt's accountant. Indeed he was not (SM p. 58, December 28, 1971 Appendix p. 60a). This work sheet was admitted into evidence over the objection of counsel to the bankrupt (SM pp. 59, 60, December 28, 1971 Appendix pp. 61a-62a). There is nothing in the record to indicate that the bankrupt either read the report, signed it or even adopted it. No testimony was elicited by the trustee from the preparer of the report (the bankrupt's brother-in-law) to see if the report was complete, what it was based upon and whether sound accounting principles were utilized in its preparation. (See SM p. 38, September 2, 1970 where the trustee admits that he did not know the papers from which the accountant worked). On September 2, 1970 at the argument to dismiss the specification, counsel to the trustee indicated that Tesser, the preparer of the report, was to be produced. Furthermore, Judge Rudin himself indicated on September 2, 1970 (p. 38) that for the trustee to succeed:

> "The testimony of these accountants (Tesser and the trustee's accountant) will have to be produced by the trustee to show the inaccuracy of the books and records maintained by the bankrupt."

At this hearing, Judge Rudin correctly stated the issue to be at page 36:

> "Well, then, let us dispose of this specification, of specification 3-C. It would appear from the discussion herein that the Trustee in order to sustain this specification would have to establish that the books and records maintained by the Debtor-Bankrupt were such that they fail to disclose that Mid-Island Dental Supply Corp. was indebted to him in the sum of $123,230.72 . . ."

Yet, three and one-half years later, Judge Rudin went far astray from Judge Mishler's remand and his own conclusion and wandered into fields foreign to the issues before him.

Gratuitous remarks made by Judge Rudin on page 5 of his decision (Appendix p. 31a) leave no doubt that the trier of the facts and law was influenced, not so much by the facts adduced at the trial, but by rumor, conjecture and testimony taken in other proceedings, possibly of Mid-Island's bankruptcy or the bankruptcy of Jacob Levy whose discharge was denied by Judge Rudin and who was the operator of Mid-Island. In referring to a "Ponzi" affair, Judge Rudin resorts to literary efflorescence and imagination. Nowhere in the trial record is there testimony of a "Ponzi" affair, a financial scheme on paper, unsupported by assets or tangible income. For five years lenders received interest at the rate of 18% from Mid-Island, a corporation which when it was finally adjudicated a bankrupt, had substantial assets liquidated by the same trustee as the trustee in this proceeding. Furthermore, Judge Rudin's decision implies that the lenders were to receive 18%, but because of the "Ponzi" scheme they were bilked out of their investments. Quite to the contrary, as we have indicated, some of those lenders received the 18% for a period of five years.

Whether CIT and FNC appeared on cards (Judge Rudin's decision, p. 6 Appendix p. 32a) again is immaterial and irrelevant. CIT and FNC were "security creditors" on the basis of chattel mortgages, whereas the cards represented only private lenders at 18% interest. Equally unimportant to the issues is whether Industrial Credit Plan appears in Schedule A-3 of the bankrupt's schedules and whether the transaction appears on the bankrupt's records (Judge Rudin's opinion, p. 7 Appendix p. 33a). Just as the CIT and FNC loans are evidenced by coupon books and the proceeds received by Mid-Island, so was the Industrial Credit Action transactions received by Mid-Island and represented by a coupon book. All of these monthly payment books were in the possession of Mid-Island who made the monthly payments.

"Confusion is added to confusion" (Judge Rudin's decision, p. 8 Appendix p. 34a). This statement by Judge Rudin is sheer nonsense when taken in the context of the issues. The confusions to which Judge Rudin refers are:

(a) Schedule A-3 vs. Tesser's report (Exhibit 8) vs. the letter of October, 1966 (Exhibit 3).

(b) Loans from CIT, First National and Industrial Credit.

(c) 3 x 5 record cards of "Ponzi" affair (Exhibit 7).

As we indicated in the preceding paragraphs, the loans from CIT, etc. are matters beyond the scope of the remand. Equally unimportant are the letter of October, 1966 (Exhibit 3) and the Tesser report (Exhibit 8). What the Bankruptcy Judge has failed to consider is the basic issue and that issue alone "do the bankrupt's records support substantially the obligations of $122,730.72 due from Mid-Island." An analysis of the evidence adduced will show that the records and documents in the possession of the trustee satisfied whatever obligation was imposed upon the bankrupt under §14 of the Bankruptcy Act.

The Evidence

An analysis of the evidence adduced will show that the documents and records in the possession of the trustee satisfied whatever obligation was imposed on the bankrupt under §14 of the Bankruptcy Act.

(a) Exhibit "J" consisting of notes and checks received from Mid-Island and in the bankrupt's possession total $50,730.72. As indicated in the letter of September 11, 1967 to the trustee (Exhibit 5), these were direct obligations to the bankrupt from Mid-Island.

(b) In addition, monies were borrowed from others totalling $56,000.00 which funds were transmitted to Mid-Island and the bankrupt gave his own notes to the lenders and received in return the note of Mid-Island. These borrowings are represented by 3 x 5 cards maintained by the bankrupt and confirmed by claims filed in the proceedings by the claimant (pp. 179-186 SM August 2, 1972 Appendix pp. 82a-89a). There is no testimony or evidence that these claimants do not appear on the 3 x 5 cards (Exhibit 7). Both the Bankruptcy Judge and the trustee were more concerned in showing discrepancies existing between the Tesser report (Exhibit 8), the October, 1966 letter (Exhibit 3) and the bankrupt's schedules (Exhibit A), all of which were adequately and satisfactorily explained by the bankrupt on August 2, 1972. More important is the fact, however, that the notes for advances totalling $56,000.00 were in the possession of the bankrupt (see SM pp. 185-186, August 2, 1972, see Appendix pp. 88a-89a and the concession of the trustee as to the existence of these notes in the hands of the bankrupt).

(c) In addition, there were two other transactions totalling $16,000.00 from Kinser & Kleiman where monies were turned over to Mid-Island.

(d) The sum total of the obligations from Mid-Island and supported by notes, checks, entries, cards was $122,730.72.

While the Bankruptcy Judge and the trustee seem to stress the inaccuracies in the pre-bankruptcy report (Exhibit 3) and the bankrupt's pre-bankruptcy letter (Exhibit 8) an explanation of this red herring may be in order. The figure of $51,333.87 (Exhibit 8) was not in conflict with the bankrupt's testimony or Exhibit "J" which indicates $50,730.72. As a matter of fact, Exhibit 8 indicated $50,730.72 together with an additional item of interest of $603.15. Again, checking the claimant's schedule in B of Exhibit 5 against Exhibit 8, we see that all are listed and accounted for. What differs, however, is the treatment of such claimants. Exhibit 8 treats the creditor as a contingent liability of the bankrupt and Exhibit 5 reflects the loan transactions as a direct obligation. The net effect, however, is the same; monies were advanced, a card prepared indicating the loan, the proceeds of the loan went to Mid-Island and the liability created on behalf of the bankrupt (Exhibit 7 and SM p. 187, August 2, 1972 Appendix p. 90a).

POINT II

There is no requirement in the Bankruptcy Act that both books and records be kept or that they be kept in any particular form of completeness and an analysis of the evidence adduced will show that the documents and records in the possession of the trustee satisfied whatever obligation was imposed on the bankrupt under § 14 of the Bankruptcy Act.

The trustee's contention seems to be not that the books and records were inadequate but that two exhibits, an unsworn letter dated October 31, 1966 (Exhibit 3) and a pre-bankruptcy statement of liabilities (Exhibit 8) indicates an indebtedness from Mid-Island to the bankrupt different from that set forth in the bankrupt's schedules. In

an analysis of the evidence, we have indicated that the bankrupt's exhibits and the trustee's exhibits indicate that the records clearly indicate that there was $122,730.72 due to the bankrupt from Mid-Island. The obligation was represented by Exhibit "J", notes and checks representing $50,780.72 and $72,000.00 of monies borrowed from others and the proceeds going to Mid-Island. Cards (Exhibit 7) were prepared for each of the creditors set forth in Exhibit 5. Notes in the possession of the bankrupt were received from Mid-Island for each of the individuals who loaned money to the bankrupt who in turn loaned it to Mid-Island (SM 8/2/72 pp. 185-186 Appendix pp. 88a-89a and concession of trustee that notes totalling $56,000.00 were in possession of the bankrupt or its counsel).

What we have indicated so far is that the bankrupt's records indicate clearly that Mid-Island was indebted in the amount of $122,730.72 to him.

As was stated in *In re Underhill*, 82 F.2d 258 (2d Cir. 1936) at page 259-260:

> "The law is not unqualified in imposing a requirement to keep books or records, and it does not require that if they are kept they shall be kept in any special form of accounts . . . To be sure, there may be records which are not books. . . ."

Thus, we see that there is no requirement that both books and records be kept or that they be kept in any particular form or degree of completeness (1A Collier [14 Ed] ¶14.32 at 1359). The Act gives the bankrupt an alternative where books and records are required, to produce either. Nor is the bankrupt under any duty to maintain books in any elaborate or scientific or special form (1A Collier *supra*, at p. 1361). Indeed, there are cases in which no duty to keep books arises. It is the nature

and extent of the bankrupt's transactions which dictate whether or not books and records were necessary and whether others in similar circumstances kept such records. Section 14(c)(2) does not prescribe a rigid standard of perfection in keeping records. All that is required is that the bankrupt present sufficient written evidence to enable creditors reasonably to ascertain the obligation of Mid-Island to the bankrupt herein (*In re Sandow,* 151 F.2d 807 (2d Cir. 1945).

It is because of the interest which creditors have in the bankrupt's "business transactions" that he is required to keep books or records. But what interest can creditors have and how important can it be when the trustee made no effort to collect any monies due in the Mid-Island bankruptcy for the Estate of Dunn, bankrupt. (SM 8/21/72 pp. 218-220 Appendix pp. 89a-91a).

We urge that the trustee has failed to establish that reasonable grounds exist to deny the bankrupt his discharge. Bankruptcy Rule 407 mandates that the trustee establish his case by a fair preponderance of evidence. Not only has the trustee failed to show that the bankrupt was under any obligation to maintain records but on the contrary the records and proof adduced show clearly that the cards, and notes indicate an obligation of approximately $123,000.00 due to the bankrupt from Mid-Island, a cause of action which the trustee neglected to pursue to the detriment of the trustee's creditors.

To deny a discharge of a bankrupt, the reasons must be real and substantial and speculation cannot be substituted for proof and the requirement is for probative facts capable of supporting, with reason, the conclusions of the trier of fact (*In re Pioch*, 235 F.2d 903 [3d Cir. 1956]).

The Bankruptcy Act relating to discharge must be construed liberally in favor of the bankrupt (See *Spach* v.

Strauss, 373 F.2d 641 [5thCir. 1967]). The reasons for denying the discharge must be real and substantial, not technical and not conjectural. (*In re Jones,* 490 F.2d 452 [5th Cir. 1974]).

As is stated by Circuit Judge Goldberg in *In re Jones, supra,* at p. 457:

> "The Bankruptcy Act was intended to be a sturdy bridge over financially troubled waters by means of which 'the honest but unfortunate debtor' may reach 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." Local Loan Co. v. Hunt, 1934, 292 U.S. 234, 244, 54 S.Ct. 695, 699, 78 L.Ed. 1230, 1235. We refuse to make it a treacherous tightrope on which the slightest misstep spells disaster and over which only the most accomplished acrobat can successfully pass."

The Court should keep in mind the beneficial policy of allowing a debtor to get a new start in business and life, and construe §14 strictly against the objector and liberally in favor of the bankrupt. *In re Tabibian,* 289 F.2d 793 (2d Cir. 1961).

CONCLUSION

The decisions of Chief Judge Mishler and Bankruptcy Judge Rudin should be reversed and the bankrupt granted his discharge.

Respectfully submitted,

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